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WILLIAMS/GREENE/WATERS/WAECHTER; NSC FOR
ABRAMS/DORAN/LOGERFO; TREASURY FOR NUGENT/ADKINS

E.O. 12958: DECL: 06/08/2016
TAGS: EFIN ECON KWBG
SUBJECT: WEST BANK/GAZA BANKERS AND MONETARY AUTHORITY HEAD
WARN OF BANKING SECTOR PROBLEMS

REF: JERUSALEM 2245

Classified By: Consul General Jake Walles, Reasons 1.4 (b) and (d).

¶1. (C) Summary: Senior representatives of banks operating in the West Bank and Gaza Strip warned June 7 that they will cease extending credit in three months as a result of non-payment of Palestinian Authority (PA) employee salaries. Rising indebtedness of PA employees will soon require banks to dramatically restrict available credit. Arab Bank, Bank of Jordan, and Cairo-Amman Bank have already stopped lending to PA employees. Although Palestinian Monetary Authority (PMA) Governor George Abed announced publicly that the banking sector remains fundamentally sound, in large part due to PMA oversight, he said the situation may deteriorate significantly after two months. Abed also noted that Palestinian Authority debt to local commercial banks had declined by USD 50 million, as of April 30, 2006, which he attributed to local banks' application of domestic revenues collected on behalf of the PA to overdrafts they held on other PA accounts. End Summary.

No Salaries/No More Loans

¶2. (C) Arab Bank Regional Manager Mazen Abu Hamdan told USAIDOffs and EconOffs June 7 that, with the exception of the Bank of Palestine (BoP), banks operating in the West Bank and Gaza have refused to pay PA employee salaries (reftel). Because the banks have refused to accept any transfer of PA funds and have not accumulated sufficient sums of domestic revenue in the PA accounts that they still hold, they do not have the means to pay salaries. He said that, since March, banks have been providing advances and loans to PA employees based on anticipated salary payments. PMA Governor Abed affirmed to EconChief and USAID Deputy Director June 8 that the PMA had encouraged banks to employ the greatest possible degree of flexibility in dealing with their customers and with the extension of credit facilities to PA employees for three months, beginning in March.

¶3. (C) Abu Hamdan noted that banking regulations governing delinquent loans will soon restrict available capital so severely that by September 1 most banks will be virtually closed for business. He explained that after three months of non-payment on a loan, banks are obligated to set aside 20 percent of the loan's value. After six months, 50 percent of the loan's value must be "classified." As a consequence, the amount of capital available for loans is declining rapidly

and, if loans continued not to be serviced for six-months, available capital will be so limited as to prohibit any additional lending in September. In fact, citing their obligations to shareholders and customers, Abu Hamdan, Cairo-Amman Bank Regional Manager Joseph Nesnas, and Bank of Jordan Regional Manager Mahmoud Takruri confirmed that three banks had recently decided to cease providing such advances and loans to PA employees due to a reluctance to take on any additional risk.

Banks Can Cope, For Now

¶4. (C) Abed said that PA employee debt had amounted to around USD 282 million in February 2006 but, due to additional loans and credit facilities provided in response to the non-payment of salaries, had grown to USD 370 million by the end of April 2006. Abed confirmed that the PMA's provisioning requirements for non-performing loans will ultimately require banks in the West Bank and Gaza to drastically restrict the availability of credit in as little as two months. However, he noted that the banks, at the PMA's request, had capitalized a significant portion of their record 2005 profits, which totaled USD 113 million, thereby increasing shareholders' equity of banks operating in the West Bank and Gaza to USD 572 million, with capital of USD 316 million. He noted, however, that if loans to PA employees are fully classified after 12 months of non-performance, those loans would exceed banks' capital.

¶5. (C) Abed also described how banking system assets had continued to grow at nine percent until the fourth quarter of 2005, reaching a peak of USD 5.6 billion. In late 2005 and the first quarter of 2006, there was a 3.5 percent decline

due to lower overall economic activity and an increase in lending, so banking system assets stood at USD 5.4 billion in March 2006. (Note: Abed cited the loan to deposit ratio as at 46 percent, lower than elsewhere, given the local economic conditions. Abed said there were no dangerous signals yet from private sector loans. He noted that most are highly collateralized and banks are undertaking some rescheduling in order to avoid classifying them as non-performing. End note.)

PA Debt Declines

¶6. (C) Abed said the PA's debt to local commercial banks had dropped from USD 610 million at the end of 2005 to USD 560 million as of April 30, 2006. He attributed this decline to banks' application of domestic revenues collected on behalf of the PA to overdrafts they held on other PA accounts. Abed noted that the Arab Bank held the largest amount of PA debt but that all of those loans were now collateralized. He also felt that BoP had sufficient coverage. Smaller banks are slightly more exposed, he said, but the amounts are small. Abed asserted that classifying PA loans, generally considered as sovereign debt, as non-performing would be highly unusual.
WALLES